

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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July 13, 2004

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Subject: *Markus B. and Cynthia Henley v. Express
Collections, et al. (In re Henley),*
Adv. No. 04-5007, Chapter 7, Bankr. No. 03-50441

Dear Counsel:

The matter before the Court is the Motion for Default Judgment filed by Plaintiffs-Debtors on June 28, 2004, the Motion for Vacation of Entry of Default and Acceptance of Answer Objecting to Discharge filed by Defendant Meade County on June 30, 2004, and the brief in opposition to Plaintiffs' default motion filed by Defendant Meade County On July 6, 2004. These are core proceedings under 28 U.S.C. § 157(b)(2). This letter decision constitutes the Court's findings and conclusions under Fed.R.Bankr.P. 7052. As set forth below, the Clerk's entry of default will stand. Defendant Meade County will, however, be allowed to file a late answer to the extent that the answer raises justiciable issues under 11 U.S.C. § 523(a)(3).

Summary of material facts. Markus B. and Cynthia Henley ("Debtors") filed a Chapter 7 petition in bankruptcy on August 27, 2003. On August 27, 2003, the Bankruptcy Clerk served notice of the commencement of the case on Debtors' creditors. The notice advised creditors that the deadline for filing a Complaint objecting to the general discharge of claims against Debtors or to determine the dischargeability of a particular debt was November 24, 2003. No party in interest objected to Debtors' discharge. The discharge order was entered November

25, 2003. The case trustee filed a report that he did not find any nonexempt assets to liquidate to pay creditors. The case was closed on December 2, 2003.

On April 19, 2004, Debtors commenced an adversary proceeding under 11 U.S.C. § 523(a)(3) against pre-petition creditors Express Collections and Meade County.¹ Debtors asked that the pre-petition claims held by the defendants be declared discharged although they had failed to timely schedule the two creditors in their bankruptcy case. In their Complaint, Debtors referenced Express Collections's judgment entered June 18, 2002, and Meade County's "lien of record" dated November 13, 2003.

Debtors did not initially serve the Meade County State's Attorney as required by Local Bankr. R. 9014-1(b)(5), but later corrected that error. Neither defendant timely filed an answer. The Bankruptcy Clerk noted the default by a docket entry dated June 21, 2004.

On June 28, 2004, Debtors filed a Motion for Default Judgment, an affidavit by their counsel in support of the Motion, and a proposed default judgment. The matter was taken under advisement by the Court.

On June 30, 2004, Defendant Meade County filed a Motion for Vacation of Entry of Default and Acceptance of Answer Objecting to Discharge. The County also filed a brief and affidavit in support of their position. In its pleadings, Meade County stated its attorney had contacted Debtors' attorney during the answer period and erroneously thought that a timely-filed answer was unnecessary to preserve its position. The County asked that the Clerk's entry of default be vacated and that it be allowed to file an answer so the matter could be heard on its merits.

¹ Debtors used the Court's electronic filing system to docket their Complaint. The Complaint listed Meade County as one of the two defendants but Debtors' counsel erroneously docketed the Meade County Register of Deeds as the defendant. The error was carried into subsequent docket text and pleadings. The Clerk's office has now corrected the erroneous docket entries.

Discussion. The Complaint filed by Debtors asked that the pre-petition claims held by Express Collections and Meade County be discharged although Debtors failed to list these creditors in their bankruptcy case. Debtors' Complaint is based on 11 U.S.C. § 523(a)(3). This Bankruptcy Code section provides that, in certain circumstances, pre-petition claims against a debtor will be discharged even though the debtor failed to list the claims in his bankruptcy schedules and also failed to give the creditors notice of the case before the discharge was entered. There are two required circumstances that must be present. First, the trustee must not have had any bankruptcy estate assets to distribute to creditors. Second (which is really a two-part circumstance itself), the unscheduled debt that the debtor wants discharged must not be of a type that could have been declared nondischargeable under § 523(a)(2), (4), or (6), and the creditor must not have had actual notice of the case before the deadline expired to file such a nondischargeability complaint. Section 523(a)(3) is one of the more complicated Code sections that provides, in essence, an exception to an exception to a debtor's discharge.

Debtors added a twist to their Complaint by asking that the "lien of record" held by Meade County be discharged, not the underlying claim held by the County. While the County's underlying claim may be discharged if it is not subject to a fraud-based nondischargeability complaint under § 523(a)(2), (4), or (6), this adversary proceeding under § 523(a)(3) does nothing to resolve whether a lien held by the County should be avoided because Debtors only pled their Complaint under § 523(a)(3). Thus, the issue of whether the County's lien, *i.e.*, the County's *in rem* right, survives this bankruptcy case will not be addressed through this adversary proceeding. Instead, the only issue presented is whether Debtors' *in personam* liability to the County can be discharged through this § 523(a)(3) action.

Debtors' *in personam* liability to the County will be declared dischargeable under § 523(a)(3) only if the circumstances required for relief under § 523(a)(3), as set forth above, are established. Thus, the County's answer should be limited to addressing whether the case trustee had any assets to distribute, whether the County's claim could have been declared nondischargeable under §§ 523(a)(2), (4), or (6), and

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whether the County had actual notice of Debtors' bankruptcy case before November 24, 2003. Whether the County's lien is dischargeable or voidable will have to await another day.

Meade County will be given 15 days to file an answer to Debtors' § 523(a)(3) Complaint. The answer shall be limited in scope as discussed above. If the County does not have any issues to raise under § 523(a)(3), it should so inform the Court by letter, and an order will be entered discharging Debtors' *in personam* liability to the County and Express Collections.

Finally, the Clerk's entry of default will not be vacated under Fed.R.Bankr.P. 7055 and Fed.R.Civ.P. 55(c). The docket entry was accurate because no answers had been filed. Also, the docket entry alone is not determinative of whether Debtors are entitled to a default judgment. It is an administrative entry under Fed.R.Bankr.P. 7055 and Fed.R.Civ.P. 55(a) that has limited further impact in this adversary proceeding based on this letter decision that allows the County to file a late answer. Further, the record does not yet show that the County has a meritorious defense to a § 523(a)(3) action regarding its *in personam* claim against Debtors. See generally *Johnson v. Dayton Electric Manufacturing Co.*, 140 F.3d 781, 783-84 (8th Cir. 1998).

Sincerely,

/s/ Irvin N. Hoyt

Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: adversary file (docket original; serve parties in interest)